Annual Performance Report

2008-09

Newfoundland and Labrador Government
Sinking Fund

BOARD OF TRUSTEES
NEWFOUNDLAND AND LABRADOR CONSOLIDATED SINKING FUNDS

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
NEWFOUNDLAND AND LABRADOR MUNICIPAL FINANCING CORPORATION SINKING FUND

DEBT MANAGEMENT DIVISION
DEPARTMENT OF FINANCE
CONFEDERATION BUILDING
P.O. BOX 8700
ST. JOHN'S, NL
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September 14, 2009

Message from the Board

I am pleased to present the Annual Performance Report for the Newfoundland and Labrador Government Sinking Fund for the 2008-09 fiscal year.

The Newfoundland and Labrador Government Sinking Fund administers the sinking funds established by the Province of Newfoundland and Labrador for the repayment of the Province's debenture debt. The effective investment and control of these funds is consistent with the Department's responsibilities with respect to stewardship of public money and management of the funded debt and supports the Department's strategic direction and commitment of sound financial management.

This performance report provides an overview of the Newfoundland and Labrador Government Sinking Fund and identifies key issues and results for the Board of Trustees during the fiscal year 2008-09. The Newfoundland and Labrador Government Sinking Fund earned a net income of almost $50 million during 2008-09, which included a foreign exchange gain of $4.3 million. An initial review of a report on the investment strategy of the Sinking Fund did not result in recommendation of changes to the investment strategy at this time.

The Board of Trustees is accountable for the preparation of this report and for the results reported therein.

Terry Paddon
Chairman

1.0 Overview

The Newfoundland and Labrador Government Sinking Fund was created pursuant to the *Financial Administration Act* to consolidate and administer sinking funds established for the repayment of the Province's debenture debt. The Province has established sinking funds for most of its long term debenture issues and the annual contributions to these sinking funds are invested by the Board of Trustees of the Newfoundland and Labrador Consolidated Sinking Funds, appointed by the Lieutenant Governor in Council to manage and control the day to day operation of the sinking funds. As at 31 March 2009, the Board of Trustees consists of the incumbents in five senio: public service positions with the Department of Finance as follows:

Terry Paddon	Deputy Minister
Donna Brewer	Assistant Deputy Minister Financial Planning and Benefits Administration
Ronald Williams	Comptroller General
Paul Myrden	Director, Debt Management
Linda Howell	Manager of Debt Servicing & Financial Risk

The Newfoundland and Labrador Government Sinking Fund operates with a March 31 fiscal year end and the results of its activities are fully consolidated in the Province's annual financial statements.

2.0 Mandate

The mandate of the Board of Trustees is to manage and control the operational activities of the Newfoundland and Labrador Government Sinking Fund and the sinking funds of certain Crown corporations where the Province has guaranteed the related debt (i.e.

Newfoundland and Labrador Municipal Financing Corporation and the Eastern Regional Integrated Health Authority). These activities include setting investment policy, investment of funds and the monitoring of such. These funds are invested in accordance with the *Financial Administration Act*, primarily in bonds, debentures or other securities issued or guaranteed by the Government of Canada, the government of a province of Canada, or a chartered bank, with the goal of earning the maximum return from investment of the portfolio while ensuring security of the funds.

3.0 Sources of Funding

For debenture issues which have sinking fund requirements, the Province makes the required sinking fund contributions to the Board of Trustees. In 2008-09, these sinking fund payments amounted to $53.0 million. Sinking fund contributions are invested and the interest earnings, less an amount to cover administrative costs, are re-invested.

The Newfoundland and Labrador Government Sinking Fund's day-to-day activities are managed by employees of the Department of Finance and the Sinking Fund is invoiced quarterly by the Province for reimbursement of these expenses on a cost-recovery basis.

4.0 Highlights and Accomplishments

- During the year 2008-09 the Sinking Fund had a net income of $49.6 million, including a $4.3 million gain due to foreign currency translation.

5.0 Financial Statements

While it is not a legislative requirement that the NL Government Sinking Fund prepare a Financial Statement, the entity has always made it a practice to prepare an annual financial statement for review and approval by its Board of Directors. For the year 2008-09, an increase in the value of the U.S. dollar resulted in a foreign currency translation gain of $4.3 million. Any gains or losses resulting from foreign currency translations will not become realized until such time the U.S. assets should ever actually be converted to Canadian dollars. Financial statements for the year ending 31 March 2009 are included in this report.

6.0 Activity Plan – 2008-11 - Update

The Newfoundland and Labrador Government Sinking Fund supports the Department of Finance in its responsibilities related to stewardship of public money and fiscal management by the investing of funds in accordance with parameters set out in the *Financial Administration Act*. A review of the investment strategy of the fund was begun in 2007-08 and was ongoing in 2008-09. As part of this review, the three year activity plan of the NL Government Sinking Fund set forth the following goals and objectives for Fund:

Goal By March 31, 2011, the Newfoundland and Labrador Government Sinking Fund will have implemented any changes recommended to the investment strategy of the fund resulting from the review of that investment strategy and will have formally documented the investment policies of the fund.

Objective

1. By March 31, 2009, the Newfoundland and Labrador Government Sinking Fund will have implemented any changes recommended to the investment strategy of the fund resulting from the review of the investment strategy.

   Measure: Report on recommendations of changes to investment strategy of sinking fund.

   Indicator: Recommendations of changes to investment strategy implemented.

   Progress: A report on the investment strategy of the Sinking Fund and subsequent information was completed during 2008-09. Initial review and consideration resulted in no recommended changes by the Board to the investment strategy at this time. Further consideration of the report by the Board is ongoing. Should a subsequent review result in recommendations for changes, it is anticipated that once approved, they would be implemented by the end of the fiscal year.

2. By March 31, 2010, the Newfoundland and Labrador Government Sinking Fund will have updated the documentation for the investment policy of the sinking fund.

   Measure: Formal documentation of investment policy of sinking fund.

Indicator: Documentation completed.

3. By March 31, 2011 the Newfoundland and Labrador Government Sinking Fund will have completed an annual review of the investment strategy and policies of the sinking fund.

Measure: Review of investment strategy and policies.

Indicator: Review completed.

NEWFOUNDLAND AND LABRADOR
GOVERNMENT SINKING FUND

FINANCIAL STATEMENTS

31 MARCH 2009

OFFICE OF THE AUDITOR GENERAL
St. John's, Newfoundland and Labrador

AUDITOR'S REPORT

To the Board of Trustees
Newfoundland and Labrador Government Sinking Fund
St. John's, Newfoundland and Labrador

I have audited the balance sheet of the Newfoundland and Labrador Government Sinking Fund as at 31 March 2009 and the statements of statutory contributions, retained earnings, revenues and expenses, and cash flows for the year then ended. These financial statements are the responsibility of the Board's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Fund as at 31 March 2009 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

JOHN L. NOSEWORTHY, CA
Auditor General

St. John's, Newfoundland and Labrador
16 June 2009

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
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31 March 2009

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NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
BALANCE SHEET
31 March

	2009 (000's)	2008 (000's)
ASSETS		
Current		
Cash	$ 32,346	$ 155
Term deposits and short-term investments, at cost	-	107,352
Interest and other receivables		
Province of Newfoundland and Labrador - guaranteed	10,497	9,213
Other	2,918	1,569
	45,761	118,289
Investments, at amortized cost (Schedule 1)		
Cost	736,167	522,011
Accumulated amortization of discounts and premiums	94,951	86,960
	831,118	608,971
	$ 876,879	$ 727,260
LIABILITIES AND SINKING FUND EQUITY		
Current		
Accounts payable and accrued liabilities	$ 11	$ 10
Due to Province of Newfoundland and Labrador	347	421
	358	431
Sinking fund equity		
Statutory contributions (Statement 2)	489,231	408,558
Retained earnings (Statement 3)	387,290	318,271
	876,521	726,829
	$ 876,879	$ 727,260

See accompanying notes

Signed on behalf of the Board:

Chairperson

Member

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF STATUTORY CONTRIBUTIONS
For the Year Ended 31 March

	2009 (000's)	2008 (000's)
Balance, beginning of year	**$ 408,558**	$ 496,829
Statutory contributions for the year	**52,967**	41,515
	461,525	538,344
Statutory contributions applicable to matured/redeemed debentures	-	(108,827)
Foreign currency translation adjustment (Note 3)	**27,706**	(20,959)
Balance, end of year	**$ 489,231**	$ 408,558

See accompanying notes

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF RETAINED EARNINGS
For the Year Ended 31 March

	2009	2008
	(000's)	(000's)
Balance, beginning of year	**$ 318,271**	$ 449,583
Excess of revenues over expenses	**49,643**	31,381
	367,914	480,964
Retained earnings applicable to matured/redeemed debentures	**(3,227)**	(159,339)
Foreign currency translation adjustment (Note 3)	**22,603**	(3,354)
Balance, end of year	**$ 387,290**	$ 318,271

See accompanying notes

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF REVENUES AND EXPENSES
For the Year Ended 31 March

	2009	2008
	(000's)	(000's)
REVENUES		
Interest income		
Debentures	$ 33,524	$ 34,576
Term deposits and short-term investments	1,987	4,689
Other	211	95
	35,722	39,360
Foreign currency translation gains (losses) (Note 3)	4,260	(17,602)
Amortization of discounts and premiums	9,902	10,676
	49,884	32,434
EXPENSES		
Loss on redemption/sales	-	831
Salaries and benefits	138	119
General	103	103
	241	1,053
Excess of revenues over expenses	$ 49,643	$ 31,381

See accompanying notes

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
STATEMENT OF CASH FLOWS
For the Year Ended 31 March

	2009 (000's)	2008 (000's)
Cash flows from operating activities		
Excess of revenues over expenses	$ 49,643	$ 31,381
Adjustment for non-cash items		
Amortization of discounts and premiums	(9,902)	(10,676)
Foreign currency translation (gains) losses (Note 3)	(4,260)	17,602
Loss on redemption/sales	-	831
	35,481	39,138
Change in non-cash working capital	(2,706)	4,879
	32,775	44,017
Cash flows from financing activities		
Statutory contributions	52,967	41,515
	52,967	41,515
Cash flows from investing activities		
Purchase of investments	(166,625)	(53,708)
Proceeds from redemption and sale of investments	-	241,230
Payments to redemption bank accounts	-	(221,061)
Payments of excess to Province upon maturing debentures	(3,227)	(2,980)
	(169,852)	(36,519)
Net (decrease) increase in cash and cash equivalents	(84,110)	49,013
Effect of foreign currency translation adjustment (Note 3)	8,949	(7,527)
Cash and cash equivalents, beginning of year	107,507	66,021
Cash and cash equivalents, end of year	$ 32,346	$ 107,507
Cash and cash equivalents include:		
Cash	$ 32,346	$ 155
Term deposits and short-term investments	-	107,352
	$ 32,346	$ 107,507

See accompanying notes

NEWFOUNDLAND AND LABRADOR GOVERNMENT SINKING FUND
SCHEDULE OF INVESTMENTS
31 March

	2009		2008	
	Face Value or Par (000's)	Amortized Cost (000's)	Face Value or Par (000's)	Amortized Cost (000's)
Canadian				
Province of Newfoundland and Labrador - guaranteed				
Province of Newfoundland and Labrador	$ 146,544	$ 156,896	$ 128,769	$ 137,094
Newfoundland and Labrador Municipal Financing Corporation	24,790	24,785	24,790	24,787
Newfoundland and Labrador Hydro	20,999	24,993	-	-
Coupons and residuals	322,890	181,668	290,228	158,310
	515,223	388,342	443,787	320,191
Other securities	94,806	95,933	54,008	55,526
Other coupons and residuals	71,314	44,171	48,207	32,749
	681,343	528,446	546,002	408,466
U.S.				
Province of Newfoundland and Labrador - guaranteed				
Province of Newfoundland and Labrador	152,864	173,377	122,298	139,708
Other securities	97,027	118,639	44,977	52,951
Other coupons and residuals	18,506	10,656	14,543	7,846
	268,397	302,672	181,818	200,505
Total investments	$ 949,740	$ 831,118	$ 727,820	$ 608,971

See accompanying notes

Authority

The Province of Newfoundland and Labrador issues debentures, most of which have sinking fund requirements. For debentures which have sinking fund requirements, the Province makes the required sinking fund payments (statutory contributions) to the Board of Trustees of the Newfoundland and Labrador Government Sinking Fund. This is an unincorporated body formed under the *Financial Administration Act*. All members of the Board are full-time employees of the Province and are appointed by the Lieutenant-Governor in Council.

1. Basis of accounting

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles. Outlined below are the significant policies followed.

(a) Cash and cash equivalents

Cash and cash equivalents include balances with banks, and term deposits and short-term investments with original maturities of three months or less.

(b) Investment transactions

(i) Purchases: Investments are initially recorded at cost.

(ii) Amortization: Discounts and premiums are amortized on a straight-line basis from the date of purchase until maturity.

(iii) Sales: Sales of investments are at a negotiated selling price. Sales are recorded at the proceeds less the investment's average amortized cost, with any resulting gain or loss also recorded.

(iv) Redemptions: On occasion, investments held in the Fund will be called for redemption by the issuer. In such instances, a gain is recorded equal to the redemption proceeds less the investment's average amortized cost.

1. Basis of accounting (cont.)

(c) Maturity of a Province of Newfoundland and Labrador debenture issue for which a sinking fund has been provided

(i) General

Provision is made for redemption at debenture maturity by investing statutory contributions in interest bearing securities and other investments. Both the contributions and the interest are used to pay debenture holders when debentures mature.

A record is maintained of statutory contributions received on account of each issue and of income allocated to each issue (retained earnings). The dollar total of an issue's statutory contributions and allocated income is called its Sinking Fund Value.

At maturity, statutory contributions are reduced by the total amount of statutory contributions received over the life of the issue. Retained earnings are reduced by the excess of the debenture's Sinking Fund Value over statutory contributions received.

(ii) Cash flow

At maturity, cash is paid into a redemption bank account in an amount equal to the lesser of the total face value of the issue or the Sinking Fund Value of the issue, less the face value of the issue held in the Fund's investments. If the issue's Sinking Fund Value exceeds the total face value, the excess is paid to the Consolidated Revenue Fund of the Province of Newfoundland and Labrador. If the issue's Sinking Fund Value is less than the total face value, the difference is paid into the redemption bank account by the Province.

(d) Cancellation of Province of Newfoundland and Labrador debentures held by the Sinking Fund upon related sinking fund debentures becoming fully funded

When the value of a sinking fund for a debenture issue equates to the outstanding principal amount of that issue, the Sinking Fund will return to the Province for cancellation any debentures of that issue held by the Sinking Fund. The cancellation of sinking fund assets results in a corresponding reduction in sinking fund equity. Interest income continues to be allocated to the sinking fund until maturity of the related debenture issue and is returned to the Province annually.

(e) Interest income

Interest income is recorded on an accrual basis.

(f) Foreign currency translation

Assets, liabilities, revenues and expenses denominated in U.S. currency are translated as follows:

(i) assets and liabilities are translated at the rate of exchange in effect at the balance sheet date; and

1. **Basis of accounting (cont.)**

(f) Foreign currency translation (cont.)

(ii) revenues and expenses are translated at the rate of exchange in effect on the dates on which such items are recognized in income during the year, or an average of such.

Gains and losses resulting from foreign currency translation are amortized on a straight-line basis over the remaining life of each issue's sinking fund.

2. **Related party transactions**

The Newfoundland and Labrador Government Sinking Fund and the Province absorb all of the operating costs, with the exception of banking and custodial fees, of the Newfoundland and Labrador Municipal Financing Corporation Sinking Fund, which is administered by the same Board as the Newfoundland and Labrador Government Sinking Fund.

3. **Effect of foreign currency translation**

At 31 March 2009, the Fund held $831,118,000 (2008 - $608,971,000) in investments as shown in Schedule 1. These investments include $302,672,000 in U.S. investments (2008 - $200,505,000).

The Fund assets, liabilities, statutory contributions and retained earnings denominated in U.S. currency are translated at the rate of exchange in effect at the balance sheet date. The Fund's revenues and expenses are translated at the rate of exchange in effect on the dates on which such items are recognized in income during the year, or an average of such. It is not the intention of the Fund that its U.S. assets will be converted into Canadian dollars.

In 2009, the translation of U.S. assets at year end resulted in a net foreign exchange gain due to a rise in the value of the U.S. dollar. In 2008, the translation of U.S. assets at year end resulted in a net foreign exchange loss due to a decline in the value of the U.S. dollar. Any gains or losses resulting from foreign currency translations will not become realized until such time that U.S. assets should ever actually be converted to Canadian dollars.

The effect of the translation is as follows:	2009 (000's)	2008 (000's)
Statutory contributions have been increased (decreased) by	$ 27,706	$ (20,959)
Retained earnings have been increased (decreased) by	22,603	(3,354)
Excess of revenues over expenses has been increased (decreased) by	4,260	(17,602)
Total impact of foreign currency translation	54,569	(41,915)
The effect of this amount on the Fund Assets is as follows:		
Investments have been increased (decreased) by	45,620	(34,388)
Cash and cash equivalents have been increased (decreased) by	$ 8,949	$ (7,527)

3. Effect of foreign currency translation (cont.)

The increase of $8,949,000 (2008 – decrease of $7,527,000) is reflected in the Statement of Cash Flows because of its impact on the Fund's cash flow position. However, the other transactions did not impact on the Fund's cash flow position and are, therefore, not reflected in the Statement of Cash Flows.

4. Financial instruments

The Newfoundland and Labrador Government Sinking Fund's short-term financial instruments recognized on the balance sheet consist of cash, term deposits and short-term investments, interest and other receivables, accounts payable and accrued liabilities, and due to Province of Newfoundland and Labrador. The carrying values of these instruments approximate current fair value due to their nature and the short-term maturity associated with them.

The Fund usually holds short-term investments in addition to the long-term investments. However, in 2009, the Fund held no short-term investments (2008 - $107,352,000) due to weakness in the rates available in the market. The cost approximates the face value as these investments are made in term deposits and guaranteed bonds with maturity occurring within 3 months or less after the initial investment. Therefore, their reported value is fair value to the Fund and there is no rate risk associated with these investments.

The Fund holds long-term investments which have an amortized cost of $831,118,000 (2008 - $608,971,000). The face value of these investments is $949,740,000 (2008 - $727,820,000). The policy and intention of the Board is to hold these long-term investments to maturity. Therefore, their reported value is current fair value to the Fund and there is no rate risk associated with these investments.

5. Income taxes

The Newfoundland and Labrador Government Sinking Fund is a Crown entity of the Province of Newfoundland and Labrador and as such is not subject to Provincial or Federal income taxes.